

amount of any special basis adjustment which the distributee partner may have for such assets. If the distributee partner receives less than his entire share of the fair market value of partnership inventory items or unrealized receivables, then, for purposes of section 732, the adjusted basis of such distributed property to the partnership shall take into account the same proportion of the distributee's special basis adjustment for unrealized receivables or inventory items as the value of such items distributed to him bears to his entire share of the total value of all such items of the partnership. The provisions of this paragraph may be illustrated by the following example:

*Example.* Partner C acquired his 40-percent interest in partnership AC from a previous partner. Since the partnership had made an election under section 754, C has a special basis adjustment to partnership property under section 743(b). C retires from the partnership when the adjusted basis of his partnership interest is \$3,000. He receives from the partnership in liquidation of his entire interest, \$1,000 cash, certain capital assets, depreciable property, and certain inventory items and unrealized receivables. C has a special basis adjustment of \$800 with respect to partnership inventory items and of \$200 with respect to unrealized receivables. The common partnership basis for the inventory items distributed to him is \$500 and for the unrealized receivables is zero. If the value of inventory items and the unrealized receivables distributed to C in his 40 percent share of the total value of all partnership inventory items and unrealized receivables, then, for purposes of section 732, the adjusted basis of such property in C's hands will be \$1,300 for the inventory items (\$500 plus \$800) and \$200 for the unrealized receivables (zero plus \$200). The remaining basis of \$500, which constitutes the basis of the capital assets and depreciable property distributed to C, is determined as follows: \$3,000 (total basis) less \$1,000 cash, or \$2,000 (the amount to be allocated to the basis of all distributed property), less \$1,500 (\$800 and \$200 special basis adjustments, plus \$500 common partnership basis, the amount allocated to inventory items and unrealized receivables). However, if the value of the inventory items and unrealized receivables distributed to C consisted of only 20 percent of the total fair market value of such property (i. e., only one-half of C's 40-percent share), then only one-half of C's special basis adjustment of \$800 for partnership inventory items and \$200 for unrealized receivables would be taken into account. In that case, the basis of the inventory items in C's hands would be \$650 (\$250,

the common partnership basis for inventory items distributed to him, plus \$400, one-half of C's special basis adjustment for inventory items). The basis of the unrealized receivables in C's hands would be \$100 (zero plus \$100, one-half of C's special basis adjustment for unrealized receivables).

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8847, 64 FR 69908, Dec. 15, 1999]

**§ 1.732-3 Corresponding adjustment to basis of assets of a distributed corporation controlled by a corporate partner.**

The determination of whether a corporate partner has control of a distributed corporation for purposes of section 732(f) shall be made by applying the special aggregate stock ownership rules of § 1.1502-34.

[T.D. 8949, 66 FR 32902, June 19, 2001]

**§ 1.733-1 Basis of distributee partner's interest.**

In the case of a distribution by a partnership to a partner other than in liquidation of a partner's entire interest, the adjusted basis to such partner of his interest in the partnership shall be reduced (but not below zero) by the amount of any money distributed to such partner and by the amount of the basis to him of distributed property other than money as determined under section 732 and §§ 1.732-1 and 1.732-2.

**§ 1.734-1 Optional adjustment to basis of undistributed partnership property.**

(a) *General rule.* A partnership shall not adjust the basis of partnership property as the result of a distribution of property to a partner, unless the election provided in section 754 (relating to optional adjustment to basis of partnership property) is in effect.

(b) *Method of adjustment*—(1) *Increase in basis.* Where an election under section 754 is in effect and a distribution of partnership property is made, whether or not in liquidation of the partner's entire interest in the partnership, the adjusted basis of the remaining partnership assets shall be increased by:

(i) The amount of any gain recognized under section 731(a)(1) to the distributee partner, or

(ii) The excess of the adjusted basis to the partnership immediately before the distribution of any property distributed (including adjustments under section 743(b) or section 732(d) when applied) over the basis under section 732 (including such special basis adjustments) of such property to the distributee partner.

See § 1.460-4(k)(2)(iv)(D) for a rule determining the partnership's basis in a long-term contract accounted for under a long-term contract method of accounting. The provisions of this paragraph (b)(1) are illustrated by the following examples:

*Example 1.* Partner A has a basis of \$10,000 for his one-third interest in partnership ABC. The partnership has no liabilities and has assets consisting of cash of \$11,000 and property with a partnership basis of \$19,000 and a value of \$22,000. A receives \$11,000 in cash in liquidation of his entire interest in the partnership. He has a gain of \$1,000 under section 731(a)(1). If the election under section 754 is in effect, the partnership basis for the property becomes \$20,000 (\$19,000 plus \$1,000).

*Example 2.* Partner D has a basis of \$10,000 for his one-third interest in partnership DEF. The partnership balance sheet before the distribution shows the following:

ASSETS		
	Adjusted basis	Value
Cash .....	\$4,000	\$4,000
Property X .....	11,000	11,000
Property Y .....	15,000	18,000
Total .....	30,000	33,000

  

LIABILITIES AND CAPITAL		
	Adjusted basis	Value
Liabilities .....	\$0	\$0
Capital:		
D .....	10,000	11,000
E .....	10,000	11,000
F .....	10,000	11,000
Total .....	30,000	33,000

In liquidation of his entire interest in the partnership, D received property X with a partnership basis of \$11,000. D's basis for property X is \$10,000 under section 732(b). Where the election under section 754 is in effect, the excess of \$1,000 (the partnership basis before the distribution less D's basis for property X after distribution) is added to the basis of property Y. The basis of property Y becomes \$16,000 (\$15,000 plus \$1,000). If the distribution is made to a transferee partner who elects under section 732(d), see § 1.734-2.

(2) *Decrease in basis.* Where the election provided in section 754 is in effect and a distribution is made in liquidation of a partner's entire interest, the partnership shall decrease the adjusted basis of the remaining partnership property by:

(i) The amount of loss, if any, recognized under section 731(a)(2) to the distributee partner, or

(ii) The excess of the basis of the distributed property to the distributee, as determined under section 732 (including adjustments under section 743(b) or section 732(d) when applied) over the adjusted basis of such property to the partnership (including such special basis adjustments) immediately before such distribution.

The provisions of this subparagraph may be illustrated by the following examples:

*Example 1.* Partner G has a basis of \$11,000 for his one-third interest in partnership GHI. Partnership assets consist of cash of \$10,000 and property with a basis of \$23,000 and a value of \$20,000. There are no partnership liabilities. In liquidation of his entire interest in the partnership, G receives \$10,000 in cash. He has a loss of \$1,000 under section 731(a)(2). If the election under section 754 is in effect, the partnership basis for the property becomes \$22,000 (\$23,000 less \$1,000).

*Example 2.* Partner J has a basis of \$11,000 for his one-third interest in partnership JKL. The partnership balance sheet before the distribution shows the following:

ASSETS		
	Adjusted basis	Value
Cash .....	\$5,000	\$5,000
Property X .....	10,000	10,000
Property Y .....	18,000	15,000
Total .....	33,000	30,000

  

LIABILITIES AND CAPITAL		
	Adjusted basis	Value
Liabilities .....	\$0	\$0
Capital:		
J .....	11,000	10,000
K .....	11,000	10,000
L .....	11,000	10,000
Total .....	33,000	30,000

In liquidation of his entire interest in the partnership, J receives property X with a partnership basis of \$10,000. J's basis for property X under section 732(b) is \$11,000.

Where the election under section 754 is in effect, the excess of \$1,000 (\$11,000 basis of property X to J, the distributee, less its \$10,000 adjusted basis to the partnership immediately before the distribution) decreases the basis of property Y in the partnership. Thus, the basis of property Y becomes \$17,000 (\$18,000 less \$1,000). If the distribution is made to a transferee partner who elects under section 732(d), see § 1.734-2.

(c) *Allocation of basis.* For allocation among the partnership properties of basis adjustments under section 734(b) and paragraph (b) of this section, see section 755 and § 1.755-1.

(d) *Returns.* A partnership which must adjust the bases of partnership properties under section 734 shall attach a statement to the partnership return for the year of the distribution setting forth the computation of the adjustment and the partnership properties to which the adjustment has been allocated.

(e) *Recovery of adjustments to basis of partnership property—(1) Increases in basis.* For purposes of section 168, if the basis of a partnership's recovery property is increased as a result of the distribution of property to a partner, then the increased portion of the basis must be taken into account as if it were newly-purchased recovery property placed in service when the distribution occurs. Consequently, any applicable recovery period and method may be used to determine the recovery allowance with respect to the increased portion of the basis. However, no change is made for purposes of determining the recovery allowance under section 168 for the portion of the basis for which there is no increase.

(2) *Decreases in basis.* For purposes of section 168, if the basis of a partnership's recovery property is decreased as a result of the distribution of property to a partner, then the decrease in basis must be accounted for over the remaining recovery period of the property beginning with the recovery period in which the basis is decreased.

(3) *Effective date.* This paragraph (e) applies to distributions of property from a partnership that occur on or after December 15, 1999.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8847, 64 FR 69908, Dec. 15, 1999; T.D. 9137, 69 FR 42559, July 16, 2004]

### § 1.734-2 Adjustment after distribution to transferee partner.

(a) In the case of a distribution of property by the partnership to a partner who has obtained all or part of his partnership interest by transfer, the adjustments to basis provided in section 743(b) and section 732(d) shall be taken into account in applying the rules under section 734(b). For determining the adjusted basis of distributed property to the partnership immediately before the distribution where there has been a prior transfer of a partnership interest with respect to which the election provided in section 754 or section 732(d) is in effect, see §§ 1.732-1 and 1.732-2.

(b)(1) If a transferee partner, in liquidation of his entire partnership interest, receives a distribution of property (including money) with respect to which he has no special basis adjustment, in exchange for his interest in property with respect to which he has a special basis adjustment, and does not utilize his entire special basis adjustment in determining the basis of the distributed property to him under section 732, the unused special basis adjustment of the distributee shall be applied as an adjustment to the partnership basis of the property retained by the partnership and as to which the distributee did not use his special basis adjustment. The provisions of this subparagraph may be illustrated by the following example:

*Example.* Upon the death of his father, partner S acquires by inheritance a half-interest in partnership ACS. Partners A and C each have a one-quarter interest. The assets of the partnership consist of \$10,000 cash and land used in farming worth \$10,000 with a basis of \$1,000 to the partnership. Since the partnership had made the election under section 754 at the time of transfer, partner S had a special basis adjustment of \$4,500 under section 743(b) with respect to his undivided half-interest in the real estate. The basis of S's partnership interest, in accordance with section 742, is \$10,000. S retires from the partnership and receives \$10,000 in cash in exchange for his entire interest. Since S has received no part of the real estate, his special basis adjustment of \$4,500 will be allocated to the real estate, the remaining partnership property, and will increase its basis to the partnership to \$5,500.